Franchise Tax Board

ANALYSIS OF AMENDED BILL

Author:	Ackerman	Analyst:	Roger Lackey	Bill Number:	SB 399
Related Bills:	See Legislative History	Telephone:	845-3627	Amended Date:	05-07-2001
		Attorney:	Patrick Kusiak	Sponsor:	

SUBJECT: Business Organizations Conversion

SUMMARY

This bill would

- establish procedures for the conversion of corporations into, Limited liability companies (LLC), Limited partnerships (LP), or General partnerships.
- establish procedures for the formation of a corporation from the conversion of a LLC, LP, or general partnership.

This analysis will only discuss the bill to the extent it impacts the department.

SUMMARY OF AMENDMENTS:

The May 7, 2001, amendments made a number of technical and substantive changes regarding the conversion of business organizations. However, these changes would have no direct impact on the department's analysis of the bill.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

The author's staff has indicated the purpose of the bill is to enable corporations to convert into other business entities.

EFFECTIVE/OPERATIVE DATE

This bill would be effective and operative January 1, 2002.

POSITION

Pending.

Board Position:			Department Director	Date
____ S	____ NA	____ NP		
____ SA	____ O	____ NAR	Gerald H. Goldberg	05/30/01
____ N	____ OUA	__X__ PENDING		

ANALYSIS

FEDERAL/STATE LAW

Current **state law** does not allow a corporation to convert into a partnership, limited liability partnership (LLP), LP, LLC, or a foreign corporation. State law also does not allow these entities to convert into a corporation.

However, **existing state law** provides specific guidelines for the conversion of LPs and LLCs into another business entity or a foreign limited partnership.

State law provides that the filing with the Secretary of State (SOS) of a certificate of conversion, a statement of partnership authority, or articles of organization containing a statement of conversion has the same effect as the filing of a certificate of cancellation by the converting entity. As a result, the converting entity is not required to file a certificate of dissolution or cancellation.

In addition, an entity that converts into another entity is for all purposes the same entity that existed before the conversion, including all rights and property of and liability for all debts, liabilities, and obligations of the converting entity.

THIS BILL

Under the Corporations Code, this bill would provide specific guidelines for the conversion of a corporation into a domestic or foreign LLC, LP, general partnership, or a foreign corporation. It would also provide for those entities to convert into a corporation.

This bill would define several terms including "other business entity." For purposes of conversions, “other business entity” would mean a domestic or foreign LLC, LP, general partnership, business trust, real estate investment trust, unincorporated association (other than a nonprofit association), or a domestic reciprocal insurer.

This bill would provide that the filing with the SOS of a statement of conversion, a certificate of conversion, or articles of incorporation in the case of an other business entity converting into a corporation, would have the effect of the filing of a certificate of dissolution by the converting corporation, or a certificate of cancellation by the converting other business entity. The converting corporation or converting other business entity would not be required to file a certificate of election or dissolution, or certificate of cancellation respectively, as a result.

No statement or certificate of conversion could be filed with the SOS until a certificate of satisfaction is received from Franchise Tax Board (FTB) verifying that all taxes imposed have been paid or secured.

However, for an entity converting from a corporation into a domestic partnership, domestic LP, or domestic LLC, the SOS would file the statement or certificate of conversion without the certificate of satisfaction from FTB.

This bill would provide that an entity that converts into another type of business entity is for all purposes the same entity that existed before the conversion, including all rights and property of and liability for all debts, liabilities, and obligations of the converting entity. The department would interpret that to include requiring the converting corporation or converting entity to file all tax and information returns and to pay any tax liabilities determined due.

This bill would make additional miscellaneous and technical amendments that would not impact the department.

IMPLEMENTATION CONSIDERATIONS

This bill provides that a corporation that converts to another type of business entity, such as an LP, would be for all purposes the same entity that existed before the conversion. However, the bill also provides that the filing of a statement of conversion has the same effect as the filing of a certificate of dissolution by the converting entity. The bill is silent on the tax consequences of any conversion. For tax purposes, corporations, LPs, and LLCs have distinct filing requirements and tax liabilities, and a conversion transaction such as those described in the bill may have significant tax consequences. As a result, the FTB would administer the bill by requiring the converted entity to file a short-period return for the taxable year ending on the date of cancellation. The new entity would then be subject to all of the filing requirements and tax obligations for that new entity from the date of conversion.

LEGISLATIVE HISTORY

AB 197 (Ackerman, Stats. 2000, Ch. 250) authorized California general partnerships to convert to California LLCs or California LPs and authorized California LLCs and LPs to convert to general partnerships and foreign and other business entities.

OTHER STATES' INFORMATION

The states of *Florida, Illinois, Massachusetts, Michigan, Minnesota*, and *New York* were reviewed for because the tax laws in those states have similarities to California's tax laws.

Each of these states has a different process for allowing business entities to convert into another business entity. Generally, each of these states requires that the surviving business entity assume all debts and liabilities of the disappearing business entity.

FISCAL IMPACT

This bill's impact on the department's costs cannot be adequately determined given the implementation problems, but are not expected to be significant.

ECONOMIC IMPACT

It is the department's interpretation that taxes normally due upon dissolution and reorganization would still be due under this billl. Any fiscal impact would represent a timing change of a few months at most rather than an absolute revenue loss.

ARGUMENTS/POLICY CONCERNS

This bill would permit an entity to dissolve or cancel (via conversion) without obtaining a tax clearance certificate. Therefore, the converting entity would not have to resolve its tax debt before cancellation or withdrawal, as required by current law. However, under this bill, the new entity would be liable for the debts of the converted entity.

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